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SUBJECT: GOS EXPLORES NEW REGIONAL FINANCING PROPOSAL

REF: BARCELONA 86

1. Summary. The GOS announced on June 3 that the Ministry of Economy and Finance is developing a new regional financing proposal that would cede more tax income to Spain's autonomous regions by 2007. The final plan will be negotiated between the central government and the leaders of Spain's seventeen autonomous regions. Minister of Economy and Finance Solbes has announced publicly that the government would consider transferring as much as 50 percent of income tax revenue to the regions, but has resisted making additional promises. End Summary.

#### Current Regional Financing

2. Under Spain's current regional financing system, the autonomous regions receive a portion of certain taxes collected by the central government in their territory: 33 percent of personal income taxes, 35 percent of the general value added tax and 40 percent of taxes collected on alcohol, tobacco and fuel. The regions are able to levy and collect taxes including: estate, gambling, electricity and transportation taxes. Corporate income taxes are controlled entirely by the central government. Due to the difference in regional economic development and therefore tax revenue, the central government makes additional transfers through a Sufficiency Fund that helps poorer regions cover medical insurance and other costs. Many regions, including the wealthier ones have large medical insurance debts. Spain's regions have been recipients of EU structural funds for infrastructure since Spain entered the EU. These funds will end for all but the very poorest regions in 2007.

#### Regions Clamoring for More Funding

3. The regions of Catalonia and the Balearic Island have developed regional financing plans that call for greater control over the taxes collected in their territories. Both regions have demanded at least 50 percent of the personal income tax, increased transfers of the value added tax, and the ability to levy and collect their own corporate income taxes in their territories. Other regions are concerned with the coming end of EU structural funds and the rising cost of medical budgets.

#### The Central Government's New Funding Proposal

4. According to public announcements and interviews with Minister of Economy and Finance Pedro Solbes, the GOS' new proposal will cede more tax revenue to the autonomous regions, but rejects most of the demands of Catalonia and the Balearic Islands.

5. Solbes has suggested as much as 50 percent of the personal income taxes collected by the central government will be ceded to the autonomous communities. The Ministry is still considering the formula to divide the income tax pool up, to balance the income between poorer and wealthier regions, and address the loss of EU structural funds. Solbes has rejected transferring more value added tax to the regions and giving regional governments control over corporate income taxes.

6. In a June 2 interview, Solbes said that the central government should give the regions more fiscal power and control over their finances. However, he stressed that the decisions would be negotiated and enacted through negotiations with Madrid, not unilaterally by certain regions. Solbes also noted that once the new financing plan is developed and enacted, the regions would need to be more responsible for their own financing and control recent deficit spending.

7. Comment: The GOS' new regional financing proposal is an effort to preempt the strident Catalanian and Balearic financing plans, as well as confront the drop in EU structural funds for the poorer regions. The negotiations this Summer in the regional Presidents' meeting and next Fall in Parliament will be difficult for Zapatero's Socialist government which is dependent on regional parties to govern. Minister Solbes has made clear he will continue to be the guardian of fiscal restraint and economic orthodoxy in the coming debate. The main weaknesses in the current proposals are how to maintain some level of funding equality between wealthy and poor regions and how to tackle the large health

care deficits many regions have accumulated. Both issues will require more than a simple 50 percent solution.

MANZANARES